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SUBJECT: TORTILLA PRICE SURGE AND CALDERON RESPONSE

REF: A. A. MEXICO 306

[1](#)B. B. 06 MEXICO 1839

[1](#)1. (U) This cable incorporates information and analysis from a Global Agricultural Information Report (no. MX7003, dated January 19, 2007) produced by Post's Foreign Agricultural Service office.

Summary

[1](#)2. (SBU) The first real economic test for the new administration has been a rapid surge in the price of tortillas, a basic food staple of most Mexicans. This has generated both public and political outcries, to which the Calderon Administration has responded with a mixed bag of measures: allowing more imports (in line with its free trade inclinations); temporary, voluntary price caps that a number of merchants have agreed to honor through the end of April (which the pro-market Calderon initially opposed); and going after corn merchants who may be artificially rigging high prices. While international corn markets are tight, there does not seem to be a significant supply problem in Mexico. Some of the white corn preferred for making tortillas has been purchased by feed corn users, but it seems more likely that grain merchants holding on to their corn while betting on higher prices has caused the sudden increase. Whether this speculative activity has been accompanied by any illegal anti-competitive practices remains to be seen, but there is already worry among U.S. grain traders that they may be unfairly targeted. In reaction to the "crisis," some Mexican commentators are calling for "food sovereignty," while others suggest Mexico should revisit its laws prohibiting the use of genetically modified seeds and consider other technologies that would raise domestic productivity. Anecdotal evidence from the past few days shows prices have already fallen in the areas that experienced the sharpest spikes, but not fast enough to silence the critics. The tortilla price hikes, as well as those of other basic products (e.g., eggs, poultry, milk), have set the stage for a "mega-demonstration" in Mexico City on January 31. End summary.

Price Spike Hits Above and Below The Belt

[1](#)3. (U) Tortillas have been the main staple of the Mexican diet for centuries, if not longer. Average annual per capita consumption of tortillas in Mexico is roughly 65.5 kilograms, which is equivalent to around ten tortillas per person per

day, comprising the bulk of poor Mexicans' caloric intake. The internal demand for white corn for human consumption, and specifically for tortillas, is met almost entirely by domestic production. Yellow and cracked corn, used primarily as animal feed, is increasingly imported from abroad. In 2004, corn tortillas accounted for 7.3 percent of total food and beverage expenditures in Mexico. Consequently, a recent spike in tortilla prices throughout the country, as much as 60 percent in some markets, has caused public outrage and provided ammunition to political forces opposed to the Calderon Administration. Opposition legislators have accused the government of protecting oligopolistic corn and tortilla distributors and demonstrators have held noisy rallies outside the gates of various government ministries, including one on January 24 in which Andres Manuel Lopez Obrador -- the man who barely lost to Calderon in last July's election and has since declared himself the country's "legitimate president" -- participated.

Corn Not Scarce, Inputs Not Pricey, Must Be Speculation

¶4. (U) In addition to the political protests, there has been much debate over who, or what, is to blame for the inflation. There are three principal candidates: 1) a corn shortage; 2) rises in other input prices such as gas and electricity; and 3) speculative activity in the grain markets. According to industry sources, corn prices have surged from 2,450 pesos per ton in December 2006 to 3,400 pesos per ton in January ¶2007. The same ton of corn cost only 1,900 pesos in December ¶2005. Such an increase would normally suggest a severe corn shortage in Mexico. However, government statistics indicate this is not the case, and that supply and demand levels are similar to those of recent years. In fact, domestic production in 2006 seems to have increased by approximately

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13 percent over 2005. Yellow corn imports fell almost four percent for the same period, but actually rose if imports of cracked corn (used for livestock feed) are factored in. Some critics fault a 2006 Fox Administration initiative to export white corn to Africa, but this amounted to only 120,000 metric tons. Others fault a trend among feed mills to use white corn for animal feed as contributing to the current price spike. As U.S. yellow corn prices climbed in response to the demand for ethanol, there was a period of time in the fall of 2006 when Mexican white corn prices were below U.S. yellow corn prices, making such a substitution rational for feed mills. Sources indicate that perhaps as much as 1.2 million metric tons of white corn was diverted from the commercial white corn food chain as a result. However, it is unlikely that either this or the Africa exports were fully responsible for driving up prices to the levels seen recently. Similarly, there have been nominal increases in prices of other tortilla inputs, such as production and transportation costs, but government-controlled gas and electricity prices have risen at a rate that is pegged to the official rate of inflation, making it hard to argue that these price increases could have been responsible for more than a fraction of the recent surge in tortilla prices.

¶5. (U) The GOM was initially cautious about blaming anti-competitive private sector practices for the surge in tortilla prices. However, as it has become more evident that there is no real economic rationale for the high corn and tortilla prices, the possibility that grain-storage firms are maximizing profits through speculative pricing is being discussed more prominently. With relatively few grain storage companies in the country (less than 50 according to industry sources), it is altogether possible that opportunities exist for these firms to withhold grain from the market and thus make extraordinary profits for limited periods of time. However, the Sinaloa corn harvest will begin in April, bringing roughly four million metric tons of white corn (almost 18 percent of last year's total domestic corn production) onto the market. This impending loosening

of the supply situation will likely lead to falling corn prices over the next few months.

Government Response -- Price Caps...

16. (SBU) However, facing widespread consumer anger in the very immediate present, President Calderon decided to take government action to bring prices down ASAP. At first, he promised to address the situation by increasing corn imports and investigating market manipulation, but opposed setting price caps. However, as protests both on the street and in the media and Congress mounted, he decided to incorporate price restraints into his strategy as well. On January 18, his Economy Secretary Eduardo Sojo signed the Tortilla Price Stabilization Agreement with a number of leading corn and tortilla merchants (ref A). The agreement, which will remain in effect until April 30, includes voluntary price ceilings and increased import permits. On prices, the agreement consists of the following measures: 1) The GOM will support Mexico's poorest communities by capping corn tortilla prices at its 22,000 parastatal retail food stores at 3.5 pesos per kilo and corn flour tortillas (which require more milling) at 5 pesos per kilo; 2) the Mexican supply agents that signed the agreement will sell white corn tortilla mix for no more than 3.5 pesos per kilo; 3) the National Corn Chamber will maintain an average price of 5 pesos per kilo of corn flour; 4) Wal-mart and members of the National Retail Store Association will sell tortillas for less than 6 pesos per kilo, and Bimbo -- one of Mexico's largest bakeries -- and the national association of tortilla makers will keep retail tortilla prices at or under 8.5 pesos per kilo. The number of tortilla makers who signed the agreement (around 5,000) is only a fraction of the entire industry (made up of perhaps 200,000 makers), and many of those not party to it have insisted they will keep their prices high as long as input costs remain high. Nonetheless, by providing relief to the poorest Mexican consumers immediately, the Calderon team is betting that it will buy itself enough time for corn prices to fall.

More Imports...

17. (SBU) To help shorten this politically uncomfortable

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waiting period, the GOM has authorized the entry of an additional 450,000 metric tons of imported white corn and 850,000 metric tons of imported yellow corn from anywhere around the world. This is in addition to the 3.67 million metric tons of imported corn (both white and yellow) it authorized from its NAFTA partners on January 2. There is not a huge amount of white corn on world markets at present, but the GOM hopes that any increased supply will induce those who may be holding corn domestically to sell sooner rather than later to avoid getting caught by lower prices. Of course, while increased corn supply would clearly benefit tortilla makers and consumers, some farmer groups are complaining that more imports will put further pressure on Mexico's own corn producers, who are generally poor, own small plots that average only two hectares in size, and suffer from very low productivity (ref B). This is an issue that the GOM will have to deal with again -- in spades -- when Mexico opens up its corn market completely at the beginning of next year to the U.S. and Canada as required by the NAFTA. For now at least, concerns about Mexico's tortilla consumers (roughly the entire population) are trumping those of its two million-plus corn farmers.

And Investigations of Anti-Competitive Practices

18. (SBU) Finally, President Calderon has ordered the Federal Competition Commission (COFECO) and the Federal Consumer Prosecutor (PROFECO) to see if any businesses have engaged in

anti-competitive practices to manipulate Mexico's corn market. Both COFECO and PROFECO have launched investigations, and Calderon has called for any parties found guilty of collusion or price rigging to be punished to the full extent of the law. According to industry sources, a number of firms involved in the grain trade are already being scrutinized. Among U.S. firms, there is growing concern that some of them are being set up to take the fall for the price spike. One American company, a major player in Mexico's grain trade, has reported to us its worries that the PROFECO investigation is being conducted unfairly, citing three examples of inaccurate PROFECO reports.

Grist for More Mills - Poultry, Sovereignty, and Biotech

¶9. (U) Perhaps due to envy, perhaps to opportunism, but definitely not due to corn prices, poultry and egg prices throughout the country have also risen dramatically in recent weeks. One Mexican poultry association reported that it is the retailers and brokers who are taking advantage of the higher prices, not the producers. In fact, industry sources claim that a 1,000 peso increase in the price of a ton of corn should lead to a mere two peso per kilo increase in the price of poultry. With chicken and egg price hikes of 25-30 percent, there is little doubt that forces other than the free market are at work here, similar to the situation with tortillas. The higher cost of all these basic food items has set the stage for a planned "mega-demonstration" in Mexico City on January 31.

¶10. (U) Many of the same groups and individuals that have been warning of a flood of inexpensive corn from the U.S. as the result of the NAFTA are now protesting high U.S. prices and the lack of affordable corn. There have been calls by several politicians and activists for a national food sovereignty program (i.e., higher subsidies for domestic farmers) to avoid the "risk" of depending on foreign countries to meet Mexico's food demands. The Calderon Administration remains firmly opposed to such protectionist rhetoric and committed to opening Mexico's corn market to the U.S. and Canada next year.

¶11. (U) Taking a more sophisticated look at the situation, other Mexicans have begun to look at how best to improve the productivity of Mexico's corn producers, including via the use of biotechnology (genetically modified corn can be imported into Mexico for consumption, but genetically modified seeds are not allowed to be planted or produced here under current law). Those proposing this approach argue that increased productivity will lead to higher domestic production, stabilizing corn and tortilla prices and making Mexico less vulnerable to world fluctuations in grain prices.

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